

Louisiana's Retirement Systems:

An Expenditure Analysis (FY96 - FY03)

Submitted to

**The Louisiana State Legislature
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**Submitted by
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Preface

This analysis is long overdue. For over a decade, Louisiana's retirement system boards have operated without legislative oversight or executive branch management while holding a "statutorily blessed" blank check to pilfer the state's coffers.

Our findings are not surprising - except for the magnitude of the waste. The current and future retirees should be aware that the future solvency of the retirement systems are anything but certain, and, given this fact, the retirement boards should have been operating lean and efficient systems - rather than the exact opposite.

Nothing in this report should be seen as an affront to the employees of the retirement systems, future retirees, or current retirees. All criticism is aimed towards the true culprits - the retirement boards and some now departed directors and assistant directors. In fact, the current director at LASERS has already begun correcting some of the problems while the recently fired director at TRSL was also open to addressing the problems.

We have rarely seen a magnitude of waste as severe as we uncovered in this analysis - the only possible challenge being the "dispro" scam in the early 1990's. But the dispro scam wasted federal money, while this outrage is primarily from much needed state funds and local school board monies.

The state has a great opportunity to make very significant inroads into the retirement systems unfunded liability - and it won't cost Louisiana a dime.

We can also bring home some very "juicy" jobs, something that hasn't been very common these days in Louisiana - again at no cost.

Finally, the participants of these retirement systems should be concerned over the manner in which these boards have operated. **The magnitude of their actions threatens the very solvency of the state's retirement systems - and thus threatens each member's future or present retirement benefits.**

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Introduction

In the early 1990's a court decision and an Attorney General's opinion determined (correctly) that the disposition (ownership) of the retirement system funds remained with the retirees and employees. Following these actions, statutory law was changed and Louisiana's retirement systems functionally began operating as independent organizations. This report is an analysis of the expenditures of the Louisiana State retirement systems since that event and focuses on the budget growth of administrative costs (personnel, operating expenses, and travel) and investment expenditures pertaining to the systems' portfolios.

For the sake of simplicity and function, only LASERS (Louisiana State Employees Retirement System) and TRSL (Teachers Retirement System of Louisiana) are considered in this report. The omission of the other systems greatly simplifies the study and compares "apples with apples", since data was not contiguous across the other systems' data. Furthermore, their omission only understates our findings, thus our conclusions contain a very conservative bias. The time period is from FY96 to FY03 (budgeted). We use budgeted figures for FY03 for two reasons:

- 1) Work on this study began during the FY03 year, thus the FY03 figures are budgeted, not actual; and
- 2) The budgeted figures are what the system boards had planned on spending that year. Due to the extreme length of time involved in this study, the LFO had to make a determination as to what period of time was to be used and stick with that period. We could not keep changing the data periods - we would never have finished.

The data and information requested for this project required a considerable amount of effort from LASERS and TRSL. The LFO recognizes and appreciates their efforts. However, in stark contrast to these retirement systems, a "normal" state agency could have readily and with minimal effort obtained the data and information requested. Both LASERS and Teachers submitted voluminous answers to our inquiries, but rarely were their answers concise, informative, or meaningful. Given the difficulty they had answering our (basic) questions, we suspect that they have no real explanation for their incredible budget growth.

This report begins with a brief but critical discussion of the statutory law under which the boards of Louisiana's retirement systems currently operate and concludes with **recommendations for overhauling Louisiana's retirement systems in order to save tens of millions of tax dollars annually, provide better service and more fiscal security for the state's retirees, and provide significant economic activity in the state.**

Major LFO Findings

Part 1: General

In 1993, statutory law was changed that shifted most of the the administration and control of the State of Louisiana Retirement Systems from the state to the state employee run retirement boards (the Boards) - but the financial responsibility to fully fund the system remained with the state (and the state taxpayers). **The state gave up fiscal control over its own retirement system but retained the responsibility to fully fund the system.**

The Retirement Boards were largely removed from executive and legislative oversight and, in essence, were given a blank check to pilfer the state's coffers without responsibility or constraint.

As a consequence of this unfortunate arrangement, the retirement boards have been allowed to abuse their fiduciary responsibility to the retirees and, as a consequence, are placing the future of the retirement system in jeopardy.

The Unfunded Accrued Liability, currently costing in excess of \$400 million per year, is scheduled to exceed \$1.5 billion in the 2020's. Currently, state payments are not even covering the interest on this debt - which continues to grow until 2012.

Retirees run the risk of losing their retirement benefits if the state is financially unable to meet these enormous payments in the future. Even if the state is able to meet these payments, these payments will create severe hardships on state services and/or state taxpayers - neither of which this state can afford to suffer.

The state retirement boards of TRSL and LASERS have the fiduciary responsibility to do whatever they can to ensure that funding needs for the retirees will be met efficiently and effectively.

The state retirement boards of TRSL and LASERS have failed miserably in this fiduciary responsibility. **They have wasted hundreds of millions of dollars on unjustified administrative costs and by entering into extremely expensive contracts with out of state investment firms that provide little benefit to Louisiana. The benefit that the state**

does receive can be performed by Louisiana citizens at a fraction of the cost. This administrative waste and (especially) the unnecessary, expensive, out of state contracts have cost the state's retirees retirement portfolio between \$450 to \$500 million over the past seven years

The constitution requires that the state make up for the loss of these hundreds of millions of dollars. **In the future, if the status quo is maintained, billions will be lost.**

The retirement boards should not be allowed to abuse their fiduciary responsibility and thereby place the retiree system portfolios in financial jeopardy.

Part 2: The Administrative Operating Budget, FY96 to FY03

TRSL and LASERS budget growth during this period is excessive and unwarranted.

Administrative budget growth (147% over seven years) far exceeds any growth for any state agency in modern history.

From FY96 to FY03:	7 year growth	annual rate
LASERS	180%	26%
TRSL	124%	18%
TRSL & LASERS (combined)	147%	20.9%
Higher ed	61%	8.7%
Dept. of Education	43%	6.1%
Legislature	43%	6.1%
Total State Budget*	42%	6.0%

* excludes retirement systems

TRSL and LASERS attribute membership growth and new legislation (additional complexity) as their rationale for this budget growth. However, over these seven years, their total membership grew by only 11%; which is only 1.6% per year. Thus, their only excuse is new legislation.

The impact of new legislation cannot and does not justify growth of this magnitude.

LASERS Administrative Growth:

From FY96 to FY03:	7 year growth	annual rate
Total Administrative Costs	180%	26%
Personnel Services	162%	23%
Total Operating Expenses	235%	34%
Travel	284%	41%
Supplies	67%	10%

Total State Budget Growth	42%	6.0%
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LASERS stunning growth far exceeds the growth of the rest of state government. In fact, **LASERS grew 428% faster than the rest of state government.**

LASERS travel growth: 284% over seven years, a 41% increase each and every year for seven years. This rate of growth is 676 times greater than the rest of state government.

Much has been said by this office (the LFO) about the very strong budget growth of state government over the past 8 years. This very strong growth pales in comparison with the retirement systems' growth.

Section 2: Investments, FY 96 to FY03

Generally, the TRSL and LASERS boards choose to contract with out of state firms to invest the retirement system's portfolio using an active investment management strategy. This process costs far more than an in-house (or state-based, private firm), broad-based, indexing investment strategy.

An in-house (or state-based, private firm), broad-based, indexing investment strategy earns approximately the same returns as an active management strategy (see below). There is a very important difference: the in-house/broad based indexing strategy is three to six times cheaper and would employ La. residents rather than "New Yorkers".

The data below compares Texas' Teachers Retirement System (which uses the in house/broad based indexing strategy) with Louisiana's Teachers (TRSL) and LASERS (both use the very expensive, New York based, active management strategy).

From FY90 to FY02, **TRSL** (Louisiana Teachers) investments generated a total growth rate of **126.9%**. They utilized a very expensive, out of state, active management strategy.

From FY90 to FY02, **Texas Teachers'** (Texas Teachers Retirement System) generated a total growth rate of **127.8%**. They utilized a very inexpensive, **in-state** (in house), broad based indexing strategy.

Texas Teachers' employs over **60 Texans** to perform its' investment strategy with **salaries ranging from \$80,000 to over \$150,000**.

La. Teachers' (and LASERS) employ New York citizens earning even greater salaries than Texas.

In FY02, **La Teachers'** spent **\$77 million to invest \$10 billion** while Texas Teacher's spent only **\$50 million to invest \$71 billion**.

Texas Teachers costs in FY02 were 946% lower than Louisiana's Teachers.

As noted above, the performance of Texas Teachers' investment strategy is equivalent to the very expensive, Louisiana funded, New York-based strategy (Texas actually slightly surpassed La. teacher's performance).

During the 7 year period, FY96 to FY02:

La. Teacher's spent a total of **\$332 million** investing a total of **\$73 billion**.

Texas Teacher's spent a total of **\$329 million** investing **\$493 billion**.

La. Teachers' average investment costs were 666% higher than Texas Teachers'.

Texas Teachers' spent \$2.4 million less than La. Teachers' in investment expenses, but invested \$420 billion more, and earned the same rate of return.

If La. Teachers' had achieved the Texas cost rate (.0007¢ per \$1 invested), La. Teachers' costs would have been \$50 million instead of \$332 million.

This is a savings of \$282 million in only 7 years, or \$40 million per year.

If we liberally assume that La. Teachers' investment costs would be twice that of Texas due to diseconomies of scale, the savings would still be \$233 million over this time period, or \$33 million per year.

If Texas were to utilize La. Teachers' investment policies, their investment costs would be over \$2.2 billion, which is \$1.9 billion higher than their actual costs.

Texas keeps this \$1.9 billion in Texas and, additionally, employs approximately 60 Texans with high paying investment jobs.

La. Teachers' exported approx. \$233 million to New York and, additionally, exported these high paying jobs to New York.

The combined LASERS/Teachers investment costs per dollar invested are over 600% higher than those of Texas over this 12 year period.

During the four year period, FY99-FY02:

During this recent, 4 year period, LASERS/Teachers spent \$95 million more than Texas in investment costs while investing \$247 billion less in assets*.

*** Note: The LASERS/Teachers investment strategy generates the same return on investment as the Texas Teachers' strategy.**

If LASERS/Teachers' achieved the Texas investment expense rate, the cost would have been \$70 million instead of \$424 million, a savings of \$354 million or \$89 million per year.

Even if LASERS/Teachers' spent twice the Texas investment expense rate (due to diseconomies of scale), the cost would have been \$140 million instead of \$424 million, a savings of \$285 million or \$71 million per year.

Louisiana has the potential to save in excess of \$70 million per year simply by changing their investment strategies to broad based, in-house (or private, in-state) indexed investing, consolidation of investment resources, and pooling of portfolios.

Furthermore, this would generate 40 to 60 Louisiana jobs earning between \$80,000 to \$150,000.

This is a win/win situation for the state government of Louisiana, its' citizens, and its' retirees.

We can generate jobs and shore up the retirement system.

The only downside is the potential loss of a few trips to the east coast, a few parties, and a few dinners.

LFO

Recommendations

- 1) Reestablish normal Legislative oversight of operations. The state's retirement systems should follow the same budgetary process as the other state agencies including the appropriations process.
- 2) Reestablish executive branch policies and practices. The state's retirement systems should follow the same policies and practices as the other state agencies. Currently, the retirement systems "pick and choose" which policies and practices that they desire. Sometimes they follow state policies, sometimes federal, sometimes they make up their own.
- 3) Retirement System Boards' role in portfolio investments decisions should be largely removed and additional emphasis placed on ensuring that retirees' benefits are efficiently and effectively received.
- 4) Establish **one agency to do all of the state's investing** (preferably the State Treasurer). Retirement system boards should have only an advisory or oversight role to this agency in regards to investing retirement system monies.
- 5) This "sole investing" agency should operate with **public, in-house employees and/or state-based, private firms.**
- 6) This agency should be required to **implement an investment strategy utilizing broad based indexing for a substantial majority of investments (80+%).**
- 7) Savings from the above recommendations, which could exceed **\$70 million annually**, should be used as additional U.A.L. funding or additional experience account funding to offset the growing deficits.
- 8) The state should reconsider the possibility of borrowing funds at the current low interest rates for the retirement systems' unfunded accrued liabilities and experience account deficits. This is being done in other states as a means of reducing the retirement system unfunded liabilities.

- 9) The state should grandfather in a portable, defined contribution system for all new employees and allow current employees the option of permanently changing to defined contribution.
- 10) The state should act as soon as possible. La. is giving “New York” approximately \$200,000 per day, every day, and providing funding for another 40 to 60 jobs at very healthy salaries - jobs that could be in Louisiana.

What benefits does Louisiana receive from New York in return for these millions?

As demonstrated above, the active management contractors do not provide anything of value above what we could do for ourselves for a fraction of the cost.

- 11) Retirement system employees and board members should not receive gifts, parties, dinners, trips, and other such bestowals from firms or individuals with whom they do business.
- 12) **The LFO strongly recommends that a very in depth financial and compliance audit be performed by the Legislative Auditor (not a private firm) on all facets of the relationship between the investment contractors and the board members with the emphasis on benefits bestowed on the boards.**

Analysis of Louisiana's Retirement System's Budget Process and Performance

RS11:535 and RS 11:883 provide for the source of funding for administrative expenses of the Louisiana State Employee Retirement System and the Teacher's Retirement System of Louisiana (respectively) and establishes the trustee boards of each retirement systems as the authority in determining the administrative budget. These statutes are presented below.*

Louisiana State Employee Retirement System (LASERS)

RS 11:535. Expense account

The expense account is the fund from which the expenses of the administration of the system shall be paid. The board shall determine annually the amount required to defray the expenses for the ensuing fiscal year. The **amount required, as determined by the board, shall be paid into the expense account from the interest earnings of the system.**

Teacher's Retirement System of Louisiana (TRSL)

RS 11:882. Expense fund

The expense fund is the fund from which the expenses of the administration of the retirement system shall be paid, exclusive of amount payable as retirement allowances or other benefits provided in this Part. The board of trustees shall determine annually the amount required to defray the expenses for the ensuing fiscal year. The **amount required, as determined by the board, shall be paid into the expense fund from the interest earnings of the system.**

LFO Comment:

The law provides that the source of funding for administration expenses is from "interest earnings". During normal economic conditions, interest earnings for either system can be in the hundreds of millions per year. The statutes do not address the number of years for which earnings can be utilized in funding administrative expenses; thus, with multiyear earnings available for spending, the potential "pot" of funds that the board can utilize for their spending is in the billions of dollars. In other words, **the boards virtually have an unlimited amount of funds to allocate for administrative costs - thus they have no functional constraint whatsoever.**

* highlights added by the LFO.

Since both system boards are granted the statutory authority to spend as much as they wish on administrative costs; the LFO contends that such unrestricted spending authority will inevitably lead to unnecessary and excessive budget growth.

As shown on the following chart, data supplied* to the LFO by TRSL and LASERS prove that this contention is correct. From FY96 to budgeted FY03, administration** costs increased from less than \$9 million to over \$21 million; a growth of 147%. This amounts to an astounding average annual growth rate of 21% per year (simple average).

Let's be clear about this:

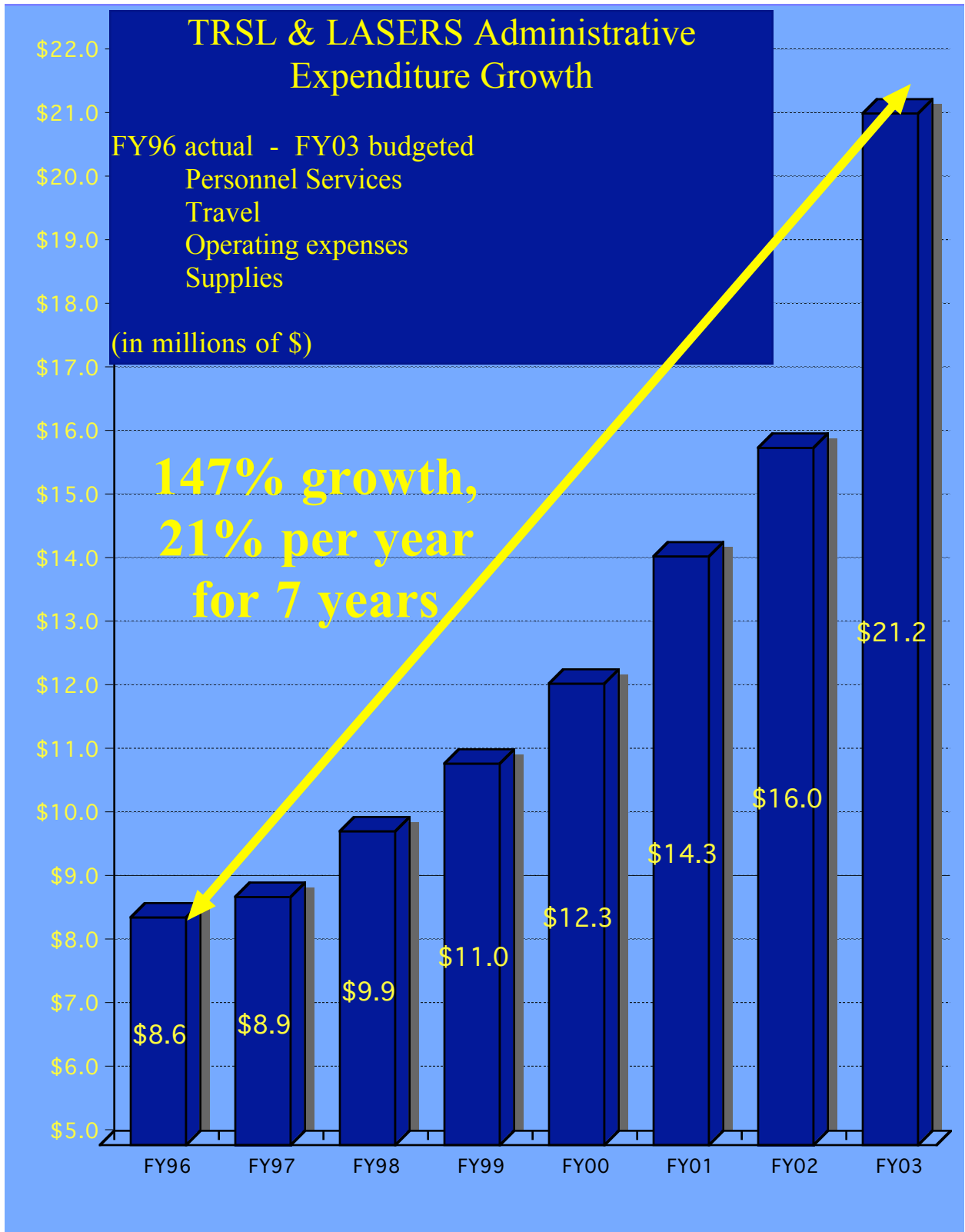
The combined LASERS/TRSL administrative budget increased by 147% in only seven years, which on an average annual basis amounts to a growth rate of 21% each year and every year for seven years!

*Unconstrained funding will lead to unconstrained spending.****

* This report focuses on TRSL and LASERS and frequently omits the smaller systems due to matters such as incomplete data, dissimilar data, or simply for expediency. It is clear that these omitted systems, due to their very small size, are inefficient and should/could be administered within a larger system very easily. Omission of the data from these systems does not materially change the analysis. If anything, omission serves to understate the findings.

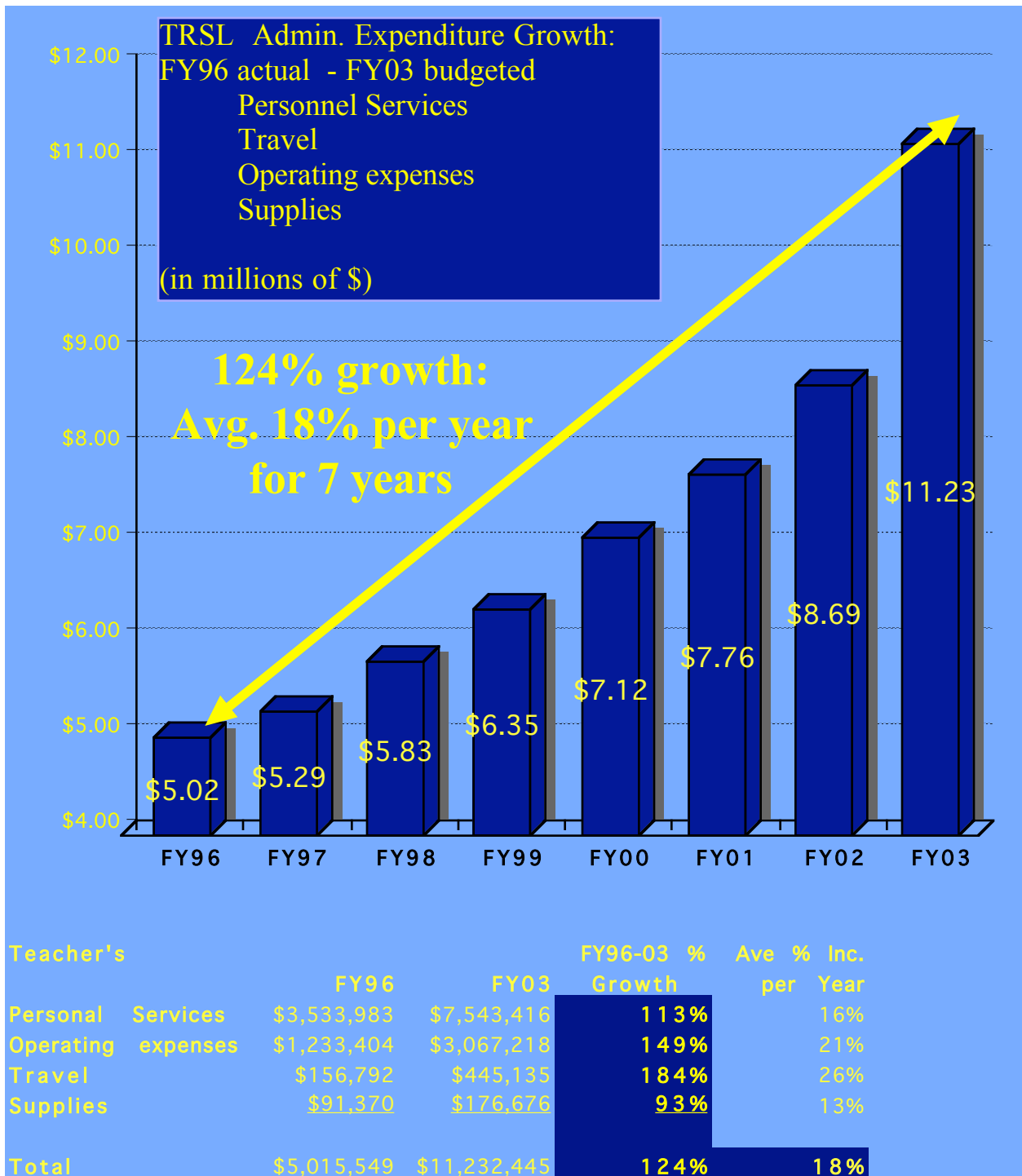
** The following expenditure categories: personnel services, travel, operating expenses, and supplies are used as a “catch all” for administrative costs. Investment expenses are not included in these costs as they represent a primary expenditure category outside of administration and are addressed at length later. Acquisitions/capital outlay expenditures are not addressed in this report.

*** To our knowledge, this is an unprecedented situation for any government agency or private sector company. La.'s retirement systems have no constraints on spending. Even the federal government has to go back to the bond market to finance its' excesses.



TRSL - Administrative Costs

Administrative cost for TRSL are shown below. Over the past seven years, TRSL has experienced extraordinary growth (124% total, 18% per year for seven years) in administrative budget expenditures.



LFO Observations on TRSL Administrative Growth:

Personnel services:

TRSL achieves growth of 113% from FY96 to FY03; a period of only seven years. This amounts to an average annual increase in excess of 16% per year.

Authorized positions increased by 50%; 52 new employees (FY96-FY03).

During this same period, the rate of inflation was at modern historic lows (in the 2% annual levels), national real economic growth was in single digits, and Louisiana economic growth in the 3 to 5 percent range.

Operating Expenses:

Operating expenses (total):

Increased from \$1,233,404 in FY96 to \$3,067,218 for budgeted FY03. This is an increase in excess of 149%, an average annual increase of over 21% per year for a seven year period. A portion of this increase is undoubtedly related to the above mentioned large personnel increase, but this growth far exceeds even this large personnel growth.

FY03 increases were especially large in this fiscal year, increasing by 41%, from \$2,180,323 (FY02) to \$3,067,218 (budgeted FY03).

Supplies:

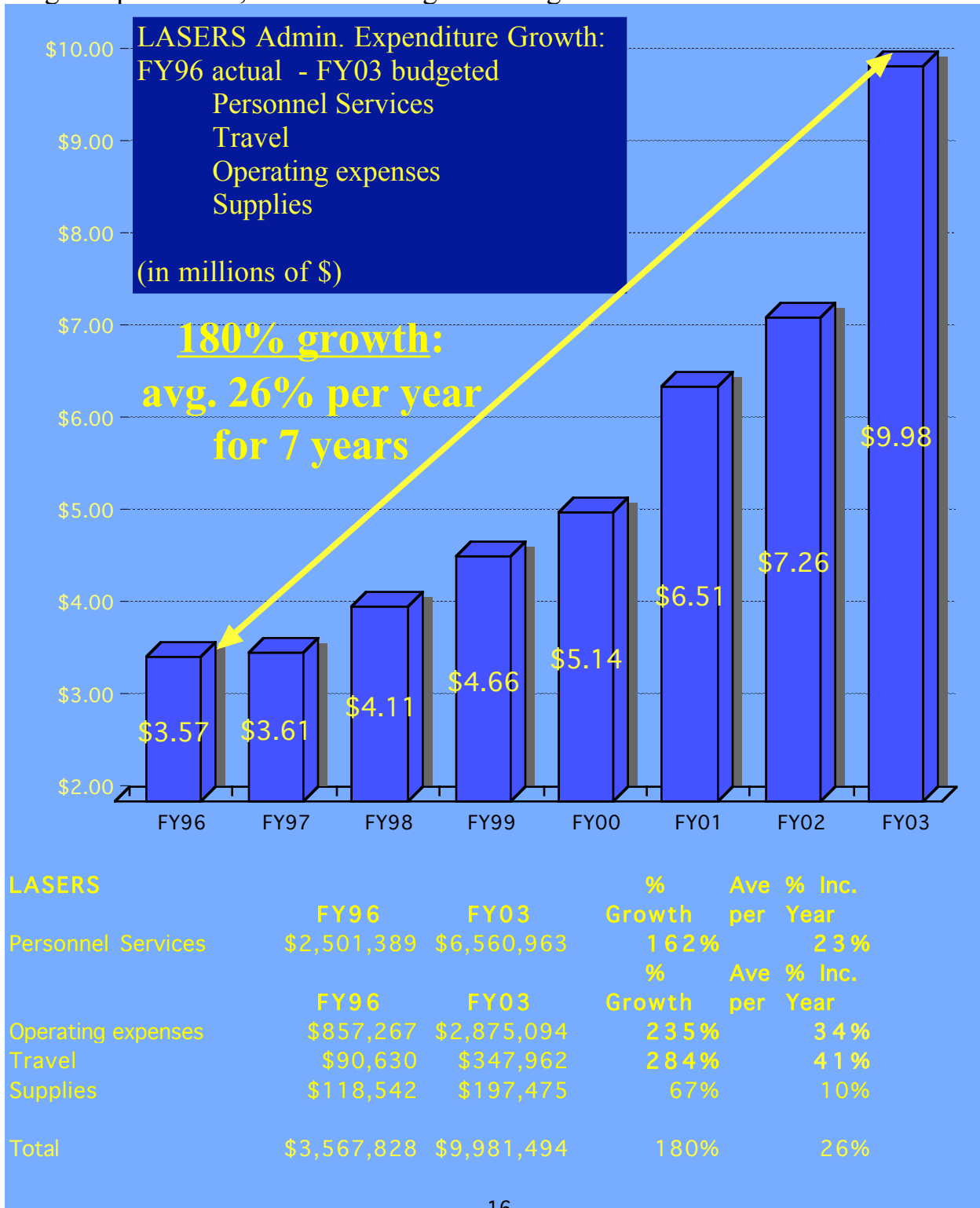
An unglamorous category for bureaucratic spending, grew by 93% for the past seven years (13% per year). Although well below the stratospheric levels attained in the personnel and travel categories, it far exceeds growth rates of the rest of government or overall private industry.

Travel:

Increased from \$156,792 to \$445,135, an increase of **184% from FY96 to FY03. This is an average annual increase of 26% per year.**

LASERS Administrative Costs

Over the past seven years, **LASERS has also experienced extraordinary growth (180% total, 26% per year for seven years)** in administrative budget expenditures, even exceeding TRSL's growth.



LFO Observations on LASERS Administrative Growth:

Personnel services:

Personnel services increased **162%** since FY96; a period of only seven years. This amounts to an average annual increase in excess of **23%** per year for six consecutive years.

During the past three years, personnel service growth has increased from \$3.7 million to \$6.6 million.

During the past three years, authorized positions increased from 85 employees to 127 employees, a 50% increase in three years.

Operating Expenses:

Operating Expenses (total):

increased from \$857,267 to \$2,875,094 from FY96 to budgeted FY03. This is an increase in excess of **235%**, an average annual increase of **34%** for a seven year period. A portion of this increase is undoubtedly related to the above mentioned large personnel increase, but this growth far exceeds even this large personnel growth.

Supplies:

Grew at a relative low rate of 67% over this period, far below the rates for personnel or travel. However even this lower growth exceeds normal government growth.

Travel:

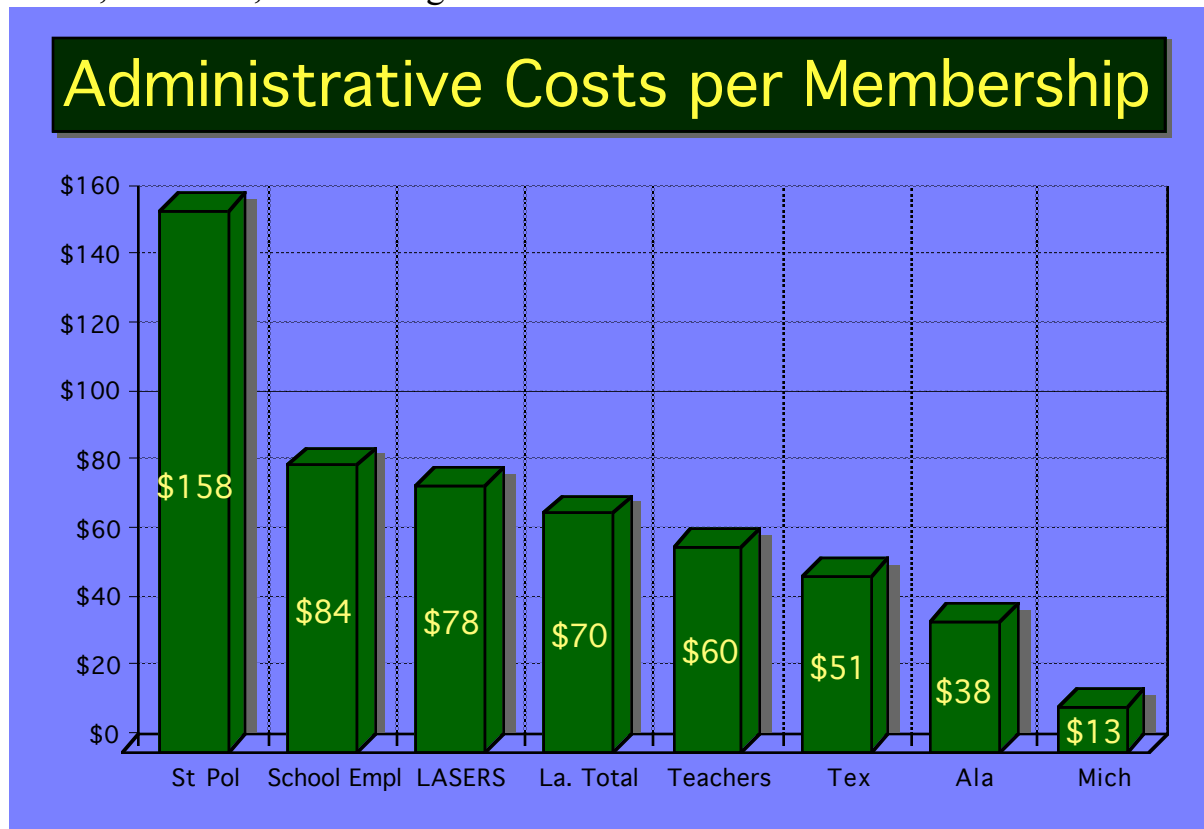
Increased from \$90,630 to \$347,962 in seven years - **this is an (astounding) increase of 284% for an average annual rate of 41% per year for 7 consecutive years.**

During this analysis of LASERS travel expenditures, the LFO found very questionable travel patterns by two state employees. This issue can be found in the appendix.

Administrative Costs per System Member

LASERS and Teacher's maintain that their administrative costs are not out of line with systems in other states. If this is true, then Louisiana was the recipient of a real bargain seven years ago before their spending explosion. There is little if any evidence that the state retirees are receiving better service today than they were seven years ago. In fact, the LFO requested performance measures from the systems to justify the spending expansion. None of the systems could respond.

Rather than establishing performance indicators as other state agencies have done (as per statutory law), the retirement systems rely on "norms" which are supposed to be "comparables" with other systems. These "comps" are developed by a private contractor hired by the systems. The contractor found that La. systems expenses were within their self-established "norms" (surprised?). The LFO sees little or no value of such reports. The only real beneficiaries are the contractor and the bureaucrats that hired them to provide "smoke" in order to cover their actions. The retirement systems should be required to submit performance indicators in the same manner as other state agencies. The LFO has prepared data that compares total administrative costs of La.'s retirement systems with those of Texas, Alabama, and Michigan.



It is clear that La.'s systems spend far more than these systems. When asked to explain their excessive spending relative to these states, the general responses offered by the La. retirement systems are as follows:

- 1) their "norms" report indicates that there is no spending problem - ignoring the specific state comparison we requested
- 2) increased workload due to increased membership
- 3) increased workload due to increased complexity of system as a result of new legislation (actuarial notes prepared by the legislative actuary fail to address these costs).

The actual workload increase as a result of these factors cannot be measured precisely but the data below demonstrates that it is obvious that the increase in workload due to membership is far below the stunning budget increases discussed above. The data shows that membership growth for this period is (at best) very moderate and in some cases negative. This clearly cannot be responsible for the alleged workload increases and thus cannot be an excuse for the spiraling budget growth. If anything, these figures demonstrate a reduction in workload relative to the workload increases received by other state agencies.

Membership Increases, FY98 - FY02				Annual	
TRSL	FY 96	FY 02	% Inc.	% Inc.	
Total Members	124,825	147,914	18.5%	2.6%	
Active Members*	85,523	98,861	15.6%	2.2%	
Beneficiaries & Annuitants	39,302	49,053	24.8%	3.5%	
LASERS	FY 98	FY 02	% Inc.	Annual	% Inc.
Total Members	125,586	130,038	3.5%	0.5%	
Active Members	72,715	67,327	-7.4%	-1.1%	
Beneficiaries & Annuitants	28,326	31,887	12.6%	1.8%	
TRSL & LASERS	FY 98	FY 02	% Inc.	Annual	% Inc.
Total Members	250,411	277,952	11.0%	1.6%	
Active Members	158,238	166,188	5.0%	0.7%	
Beneficiaries & Annuitants	67,628	80,940	19.7%	2.8%	

During the past decade, the majority of state agencies have experienced very large workload increases and, in contrast to the retirement systems, have not had a infinite amount of funding to address this workload. In many cases these agencies have had to absorb substantial increases in workload with only moderate increases in funding. Fortunately, they have turned to innovation, technology, and hard

work to meet the additional demands - in stunning contrast to the unsupervised spending spree experienced by the retirement systems.

The LFO is one example of how an agency can meet the dual challenge of tremendous workload increases while experiencing tight budgets. Since the early 1990's, the LFO fiscal note workload has increased from 400 to 500 fiscal notes per year to a current load of between 2,000 to 3,000 per year. Concurrently, as a result of a very constrained budget, the LFO has had to reduce personnel from 24 employees down to only 19.

Statistically, this translates into a gross workload increase of between 300 to 650 percent before factoring in the personnel reductions of over 21 %. What is the impact on workload per LFO employee? The fiscal note workload has increased by a factor of between 5 to 9 times greater per employee than that of the early 1990's. Additionally, the LFO has been given many other additional assignments, such as performance budgeting, impact statements, etc. which are very important but also very time consuming and frequently quite tedious.

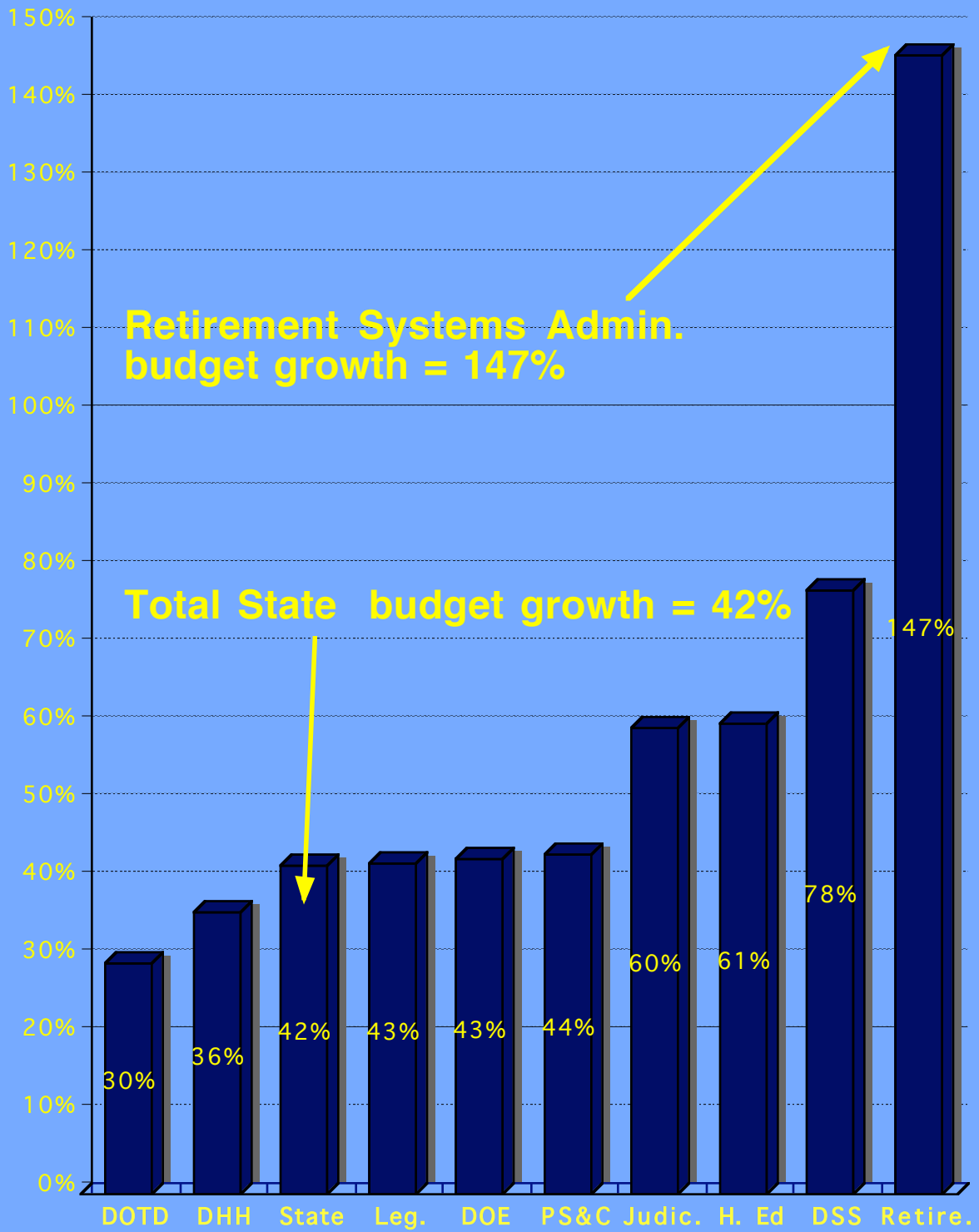
Concurrent with the workload increase, the LFO was faced with budget constraints. We have met the challenge of these spiraling workload increases and a 20+ decrease in personnel by implementing the latest in technology, rewarding the best workers, and changing the work place environment to maximize productivity.

The chart on the following page compares the major state agencies budget growth from FY96 to FY03. As shown, state government as a whole has experienced very strong budget growth (42% overall growth) in partially in response to their large workload increases over this seven year period. But their spending increases pale in comparison to the incredible growth experienced by the retirement systems (147%).

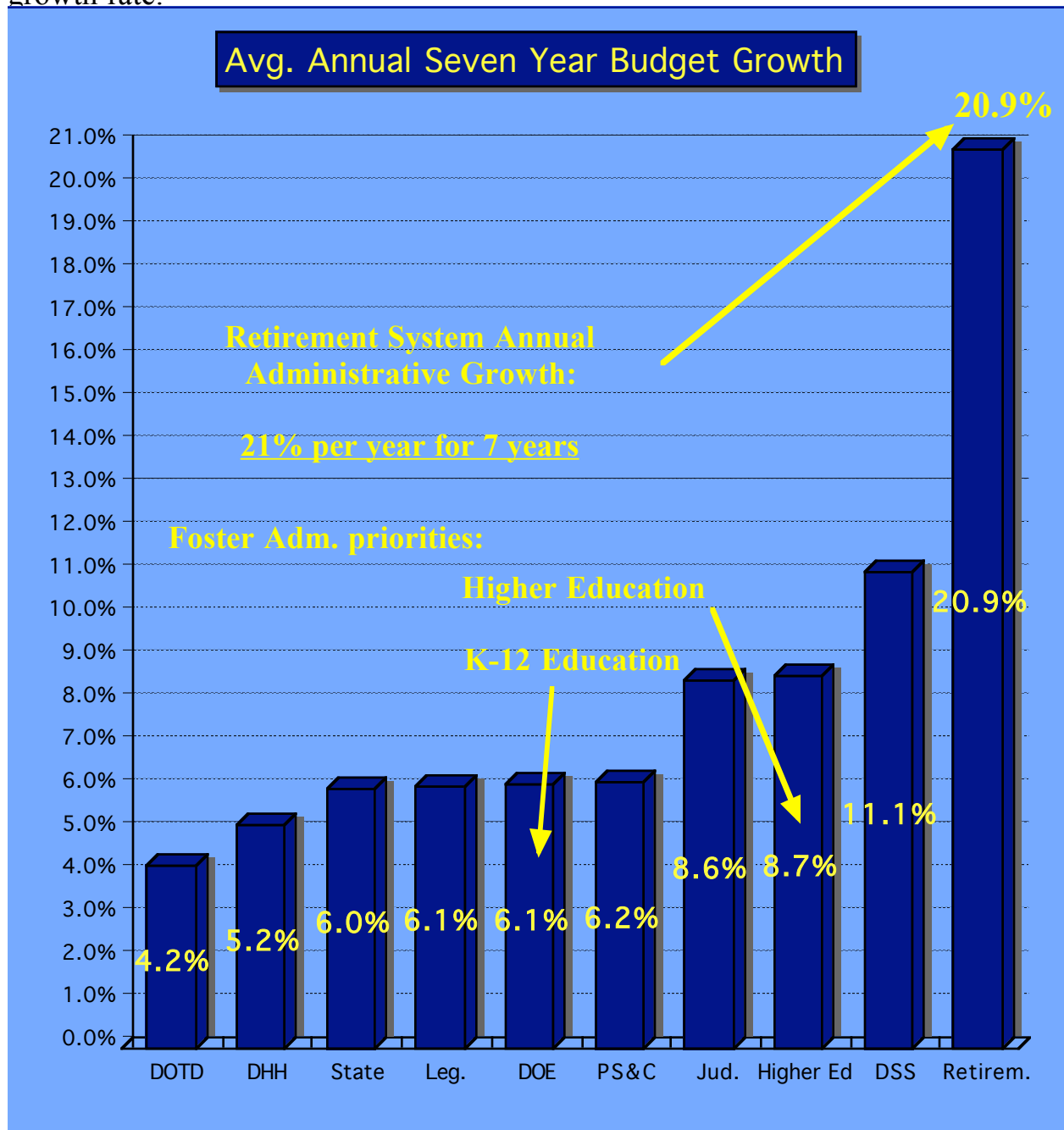
While many needs of the citizens of this state go unmet due to a lack of available funding, the retirement systems spend as if money is no object. No agency comes even close to the growth of the retirement systems. The Dept. of Social Services is the closest with a 78% growth from FY96 to FY03 budgeted. Clearly, this is not an efficient or intelligent way of allocating scarce resources.

The state taxpayers, state and local governments, and state retirees are being shortchanged by this irrational process where irresponsibility is condoned while the needs of the state's citizens are unmet.

FY96-FY03 State Agency % Budget Growth



Below is the average annual percentage growth for state agencies. Note that despite the Foster administration's successful efforts to substantially increase Higher Ed and K-12 Education (DOE) funding, their annual growth rates (8.7% and 6.1% respectively) are absurdly small in comparison to the retirement system's administrative growth (21%). Clearly the administration of the state's retirement system should not be a major priority - and even if it were, the growth rate should then be in the 6-8% range - not the astronomical 21% average annual growth rate.



Even the Dept. of Social Services, which initiated large, new, federal programs such as TANF (Temporary Aid to Needy Families), did not achieve growth rates anywhere near the retirement systems annual rates (11% versus 21%). The powerful judiciary, which usually receives funding in line with their requests, grew at a very strong 8.6%, but far short of the retirement systems.

The system directors currently running Teacher's and LASERS were not at the helm at the time of the explosive expenditure growth. The director of LASERS has already taken some steps to correct their course by reducing the general operating budget in FY03 by approximately 10%. A small reduction relative to recent growth, but at least it's a start. The director at Teacher's with whom we conversed has since been removed by the board. No specific reasons were given.

The Source of the Problem: Removal of Legislative Oversight and Executive Branch Management

As discussed earlier, a court ruling determined that the ownership of the retirement funds belonged to the retirees. The LFO agrees with this position. However, following this ruling the legislature shifted the **the administration of the State of Louisiana Retirement Systems from the state to the state employee run retirement boards (the Boards) - but the financial obligation to fund the system remained with the state (and the state taxpayers).** **Thus the state lost fiscal control over its own retirement system but maintained the responsibility to fully fund the system.** Such a doltish arrangement would never happen in the private sector and, to our knowledge, the only public sector where it has happened is ---- **LOUISIANA.**

The Boards are free to spend without responsibility or constraint. An increase in spending, regardless of merit, reduces the amount of money available to meet the retirement system's obligation to its members (retirees). The constitution requires that these obligations to the retirees be met and that the state achieve full (100%) actuarial funding by 2029. Billions are needed to meet this full funding requirement - and the constitution requires the state bear responsibility to meet this requirement. State retirees should be very concerned over the future fiscal viability of their system - this waste should be stopped and these monies used to help shore up the system.

Louisiana state government (and thus the taxpayers) have functionally lost financial control over its own retirement systems.

Retirees run the risk of losing their retirement benefits if the state is financially unable to meet the enormous payments needed to fund the system in the future.

A Private Sector Comparison

A quick comparison with the private sector may help clarify the absurdity of Louisiana's situation.

The following assumptions will approximate the private sector equivalent of Louisiana's retirement system operations.

- 1) A CEO of company "A" appoints its employees (and retirees) to administratively run "A's" retirement system
- 2) The CEO allows them to spend whatever amount they choose in administering it without any oversight
- 3) The CEO states that any shortfall in A's retirement system will remain the responsibility of company "A", regardless of waste, and will be paid by the company.

Who is really paying for any wasteful spending created by this CEO's arrangement?

The shareholders - through a reduction in profits which results in a decrease in stock values or lower dividends.

How long would this type of arrangement be allowed to exist?

Not past the first shareholders meeting where the CEO would quickly be fired and the new CEO would regain control over its retirement system's operating budget (not the corpus of retirement funds which are used for benefit payments, but operational expenses).

How long has Louisiana allowed this situation to exist?

In excess of a decade.

When will Louisiana change?

We can't change soon enough.

In this report, the LFO has identified questionable administrative spending resulting in the potential loss of over \$5 to \$10 million dollars per year (Section 1) and has identified another \$70 million of unnecessary, unproductive, out of state investment spending (Section 2).

What would it cost in tax breaks for the
Department of Economic Development
to land a firm that is

pollution free,

adds

40 to 60 new, permanent jobs

with pay ranges of

\$80,000 to \$150,000

per year

and agrees to give the state

\$50 to \$70 million

a year?

Louisiana can have this tomorrow
for nothing!

because it is paying for it already....

the jobs are funded,

the income is being generated,
and

the work is being done

but Louisiana's retirement systems have

chosen to export this work to.....

New York!

Read Section 2 below for the explanation

Section 2

Comparison of Investment Earnings, FY90 through FY02

La. Teacher's versus Texas Teacher's

During the 12 year period, from FY90 through FY02, both systems achieved approximately the same average annual rate of return; where Texas earned 9.83% and Teachers earned 9.80% annually.

Portfolio	Earnings						
Year	FY 90	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
Texas	0.1%	23.2%	11.9%	13.4%	-0.5%	22.4%	12.6%
Teacher's	8.6%	9.5%	14.5%	13.9%	1.2%	16.3%	14.9%
Year	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02	
Texas	25.4%	8.0%	14.8%	7.9%	-5.0%	-6.4%	
Teacher's	16.6%	18.7%	10.0%	14.4%	-4.1%	-7.6%	

Texas cumulative	127.8%
Teachers cumulative	126.9%

Texas' average annual earnings	9.83%
Teacher's average annual earnings	9.76%

LASERS and the other Louisiana systems achieve earnings similar to the above. However, Texas uses broad based/in house investing whereas the Louisiana systems and many other retirement systems out source at great expense. As shown, over time the results are functionally the same, which raises the important question:

Why does La's TRSL spend tens of millions on out of state "experts" to get the same results as Texas does with mostly in-house staff?

These disparities in cost are brought forth vividly below.

Teacher's versus Texas

(in millions of \$)

Fair Value of Investments:

	FY96	FY97	FY 98	FY 99	FY 00	FY 01	FY02	FY96-FY02
Texas	\$49,613	\$61,576	\$65,728	\$79,092	\$88,054	\$78,731	\$70,686	\$493,480
Teachers	\$7,559	\$8,672	\$10,821	\$11,199	\$12,476	\$11,707	\$10,510	\$72,945

Investment Expenses:

	FY96	FY97	FY 98	FY 99	FY 00	FY 01	FY02	FY96-FY02
Texas								
Invest. Expenses*	\$5.7	\$5.9	\$5.1	\$4.7	\$9.5	\$11.9	\$12.9	
Broker fees	<u>\$29.2</u>	<u>\$49.5</u>	<u>\$40.7</u>	<u>\$35.0</u>	<u>\$46.6</u>	<u>\$35.7</u>	<u>\$37.0</u>	
Total Inv. Expenses	\$34.9	\$55.4	\$45.8	\$39.6	\$56.1	\$47.6	\$49.9	\$329

	FY96	FY97	FY 98	FY 99	FY 00	FY 01	FY02	FY96-FY02
Teachers								
Invest. Expenses*	\$18.8	\$25.5	\$30.0	\$29.2	\$36.2	\$51.8	\$67.9	
Broker fees	<u>\$9.0</u>	<u>\$9.5</u>	<u>\$9.5</u>	<u>\$10.6</u>	<u>\$12.5</u>	<u>\$11.7</u>	<u>\$9.5</u>	
Total Inv. Expenses	\$27.8	\$35.0	\$39.6	\$39.8	\$48.7	\$63.5	\$77.4	\$332

Investment Costs per Dollar Invested:

	FY96	FY97	FY 98	FY 99	FY 00	FY 01	FY02	FY96-FY02
Texas								
With Broker fees	\$0.0007	\$0.0009	\$0.0007	\$0.0005	\$0.0006	\$0.0006	\$0.0007	\$0.0007
With/o Broker fees	\$0.0001	\$0.0001	\$0.0001	\$0.0001	\$0.0001	\$0.0002	\$0.0002	\$0.0001

	FY96	FY97	FY 98	FY 99	FY 00	FY 01	FY02	FY96-FY02
Teachers								
With Broker fees	\$0.0037	\$0.0040	\$0.0037	\$0.0036	\$0.0039	\$0.0054	\$0.0074	\$0.0045
With/o Broker fees	\$0.0025	\$0.0029	\$0.0028	\$0.0026	\$0.0029	\$0.0044	\$0.0065	\$0.0035

* (w/o broker fees)

Conclusions on Teacher's Investment policies:

During the 12 year period, from FY90 through FY02, both systems achieved approx. the same average annual rate of return on investments (Texas =9.83%, Teachers= 9.80%).

From FY96 through FY02:

Texas spent \$329 million to invest \$493 billion (.0007 cents per dollar invested).

Teacher's spent \$332 million to invest \$73 billion (.0032 cents per dollar invested).

Teacher's investment costs are six hundred sixty six percent (666%) higher than Texas's investment costs.

Texas spent \$2.4 million less than Teacher's in investment expenses, but invested \$420 billion more, and earned the same rate of return.

If Teacher's had achieved the Texas investment rate (.0007¢ per \$1 invested), Teacher's costs would have been \$50 million instead of \$332 million.

This is a savings of \$282 million in only 7 years, or \$40 million per year.

If we liberally assume that Teacher's inv. costs would be twice that of Texas due to diseconomies of size, the savings would still be \$233 million over this time period, or \$33 million per year.

If Texas were to utilize Teacher's investment policies, their investment costs would be over \$2.2 billion, which is \$1.9 billion higher than their actual costs.

Texas keeps this \$1.9 billion in Texas and, additionally, employees approx. 60 Texans with high paying investment jobs.

Teacher's exported \$233 million to New York and, additionally, exported these high paying jobs to New York.

LASERS

	FY 99	FY 00	FY 01	FY 02	4 year totals
Fair Value of Investments	\$5,947,727,195	\$6,491,884,625	\$5,849,323,373	\$5,529,534,953	\$23,818,470,146
Investment Activity Expense	\$16,071,796	\$19,295,553	\$18,666,270	\$17,213,862	\$71,247,481
Broker fees	\$4,812,137	\$6,292,375	\$5,111,742	\$4,739,834	\$20,956,088
Total Investment Activity Expense	\$20,883,933	\$25,587,928	\$23,778,012	\$21,953,696	\$92,203,569
Investment Expenses* per dollar Invested					
With Broker fees	\$0.0035	\$0.0039	\$0.0041	\$0.0040	\$0.0039
With/o Broker fees	\$0.0027	\$0.0030	\$0.0032	\$0.0031	\$0.0030

LASERS earnings are similar to those of Teacher's

From FY98 through FY01, LASERS spent \$92 million to invest \$24 billion (.0039 cents per dollar invested)

LASERS's investment costs are 549% higher than Texas's investment costs

If LASERS's had achieved the Texas investment cost rate (.0007¢ per 1\$), LASERS's costs would have been \$16.8 million

This is a savings of \$75 million in only 4 years, or \$19 million per year

If we liberally assume that LASERS's cost rates should be twice that of Texas due to diseconomies of size, the savings would still be \$59 million, or \$15 million per year.

LASERS's pays over 500 percent more per dollar than Texas but achieves the same returns on investments.

LASERS's exports these investment \$ and the investment jobs to New York firms whereas Texas employs Texans for their investments while saving millions.

***Broker fees** are commissions charged by an individual or firm that handles investor's orders to buy and sell securities (stocks, bonds, options, or commodities). These commissions are based on the dollar value of the transaction.

Investment expenses represent fees paid to portfolio managers and other costs related directly to either acquiring or managing investments. Management fees are generally tied to the market values or the assets under management.

LASERS/Teachers (combined) versus Texas

Fair Value of Investments	FY 99	FY 00	FY 01	FY 02	4 year totals
LASERS/Teachers	\$17,146,793,259	\$18,968,306,725	\$17,556,210,857	\$16,039,435,050	\$69,710,745,891
Texas	\$79,092,220,293	\$88,053,982,788	\$78,731,130,923	\$70,686,015,393	\$316,563,349,400
Total Investment Activity Expenses					
LASERS/Teachers	\$60,683,068	\$74,294,920	\$87,242,982	\$99,356,580	\$423,964,996
Texas	\$39,614,795	\$56,117,373	\$47,581,097	\$49,885,573	\$329,326,246
Investment Expenses per dollar Invested (With Broker fees)					
LASERS/Teachers	\$0.0035	\$0.0039	\$0.0050	\$0.0062	\$0.0061
Texas	\$0.0005	\$0.0006	\$0.0006	\$0.0007	\$0.0010

The LASERS/Teachers investment costs per dollar invested are over six hundred percent higher than those of Texas.

During the four year period, FY99-FY02, LASERS/Teachers spent \$95 million more than Texas in investment costs while investing \$247 billion less in assets.

If LASERS/Teacher's achieved the Texas investment expense rate, the cost would have been \$70 million instead of \$424 million, a difference of \$354 million or \$89 million per year.

If LASERS/Teacher's spent twice the Texas investment expense rate, the cost would have been \$140 million instead of \$424 million, a difference of \$285 million or \$71 million per year.

Louisiana has the potential to save in excess of \$70 million per year by changing their investment strategies to broad based, in-house (or at least in state) indexed, investing, consolidation of investment resources, and pooling of portfolios.

Texas relies primarily on a broad based/in house investment process with only a small amount of outsourcing, whereas the Louisiana systems out source their investments. Out sourcing is very expensive and, over time, does not produce any advantage over the broad based/in house process. In fact, as shown above, Texas actually out performed the very expensive Louisiana contract “experts”. Over time, both methods will move to the “average rate of return”.

Besides the very high price, one of the problems with out sourcing is apparent:

How does one determine which firm that provide the highest returns, i.e., which firm will have the hot hand?

There are only two ways that this can be determined:

- 1) Heavenly intervention (information from heaven is not likely to happen)
- 2) Insider trading (this is illegal)

There are no other ways to determine the winners and losers; it is a “gamble”. The LFO inquired of the boards as to how they determine the appropriate contractor. None of the answers addressed this issue, instead, they responded with statements such as, “We picked the firm that best met our investment strategies”. This ignores the fact that none of these strategies can beat a long term, broad based, indexing approach over time. It should be noted that many of the retirement systems through the country out source their investment needs. Louisiana’s systems have done peer reviews that imply that their expenditures are in line with “norms” - norms for out sourcing.

The real issue is that Louisiana has the opportunity to save hundreds of millions of dollars and, additionally create dozens of high paying jobs. What is the downside, if any, of switching to a broad based/in house process?

There is no downside for Louisiana as a whole. The only downside will occur to the (New York) contractors and the select few board members and staff that benefit from the trips to New York, the meals , etc. The fact is that Louisiana is, in reality, paying hundreds of millions of dollars and forgoing dozens of high paying jobs and gaining only a few “free” trips, a few “free” parties, and a few “free” meals.

LFO Conclusions

Removal of legislative/executive branch budgetary control of the retirement systems has resulted in virtually unbridled spending by the state's retirement systems; with the resultant skyrocketing of operating costs and the cumulative waste of hundreds of millions of taxpayer dollars during the time period of this study. The LFO very conservatively estimates that the loss to the state is in the \$450 million to \$500 million range over seven years (FY96 - FY03).

The LFO recognizes that the state has a constitutional duty to fully meet the obligations and benefits of **its' retirement systems** which includes the constitutional requirement to fully fund the system by 2029. These obligations could, should, and must be met. However, we strongly disagree that this obligation should translate into the transfer of the control of the administration of the **state's retirement system** from the state to the employees/retirees while the financial obligations of funding the system remain with the state. Under these terms, the state employees/retirees charged with running the system have an unrestricted blank checkbook - funded through precious taxpayer dollars - without oversight. They are accountable to no one but themselves.

A private sector business could not survive under such an witless arrangement. The outcome is obvious even to the completely naive - one need only look at the explosive growth in operating costs since the statutory change and the normal growth before the ruling.

The single largest areas of waste is in the investment arena, where the retirement system boards have contracted with out of state firms and paid hundreds of millions more than is necessary for investment services.

The bill for this waste is handed to Louisiana taxpayers in the form of higher taxes and/or reduced services. - meanwhile the unfunded liability is getting bigger, not smaller despite the state's additional U.A.L. payments of over \$400 million per year. These wasted millions do not go towards additional services for the retirees. The vast majority of these funds are exported to "New York" to subsidize swank investment offices and lifestyles. In fact, this spending threatens the future viability of the state's retirement system by draining away hundreds of millions of dollars that should be applied to the U.A.L. to offset the ever increasing debt. The debt continues to grow until 2012, but significant increases in funding will be needed.

The LFO recognizes that the systems contract for “peer” or norm reviews and, according to these reviews, they are not “out of line” relative to other (selected) states. This method ignores the glaring fact that the “norms” for our prosperous and successful neighbor, *Texas, is far out of line with these “peer” reviews - out of line in a very positive way.*

The LFO inquired as to why the systems don’t follow the Texas model. Their response was to repeat the mantra that they are in line with their “peers”. The retirement boards have not seriously entertained a move to the Texas model, but cannot provide an explanation as to why they should not. In fact, it is apparant that, prior to this study, they were unaware of the extreme difference between the high costs of their operations and Texas.

One would wish that the peer review contractor would be skilled enough to recognize the need to analyze such a phenomena. But that really isn’t the purpose of that contract - the contract’s purpose is to provide “cover” for the excessive spending, not condemn the spending. We are certain that the contractor wouldn’t have a contract in the future if a critical analysis were performed. This is all the more reason that La.’s retirement systems should be participating in the state’s performance review process (LASERS and TRSL are state agencies) where their performance would be monitored by the LFO three to four times per year rather than once every decade.

One upper level retirement system employee (name protected) has admitted to the LFO that the Texas model was, indeed, vastly superior. Very substantial cost savings and efficiency improvements can be achieved but will require a complete change in how the state’s retirement systems function. These savings are very substantial, in the \$70 million per year range through changing investment strategies and \$5 to \$10 million per year from administrative efficiencies.

When these savings are realized, the **LFO urges that they be used strictly as additional payments to the U.A.L. to shore up the massive unfunded accrued liabilities in the retirement systems and the projected shortages in the experience accounts.** Cash injections in the \$70 million per year range will have a tremendously positive effect on the out year liabilities.

It is important to note that the projected UAL shortfall continues to grow from approximately \$8.5 billion today to over 10.5 billion by 2012, despite the hundreds of millions that Louisiana is pouring into the system (over \$400 million

in FY03). The annual payments will continue to grow, eventually exceeding over \$1.5 billion per year. In fact, **the current state contributions to the U.A.L. do not even cover annual interest costs**, as shown below. Adding \$70 million annually to the state's payments by eliminating waste would cover this deficit in a few years and start a compounding effect in paying off the U.A.L. The sooner the reform, the greater will be the impact.

There is reason to be concerned over the ability of future citizens to fund the ever increasing U.A.L. payments - which eventually exceeds \$1.5 billion.

The unfunded liability is still increasing and threatens the future viability of the state's retirement system.

Louisiana has far too many needs and problems to allow any state agency to squander resources of this magnitude. The citizens of Louisiana and its' state retirees should demand that a complete overhaul of the operations of the retirement systems be done immediately. Dollars are needlessly flowing to New York by the truckloads each day that we sit idle (approx. \$200,000 per day).

APPENDIX

LFO Comments on Specific Issues with LASERS Travel Expenditures

Besides the extraordinary growth in travel expenditures, the LFO found very disturbing and questionable issues in regards to the travel of two individuals. Below is the travel record for these individuals, as best that we could obtain.

One of these individuals serves as a LASERS board member and an executive branch department secretary (Department of Revenue). Although much of this travel occurred with the Department of Revenue, we believe that this employees actions must be viewed in the aggregate to get a complete picture. The following occurred within a 32 month period (< 2 years and 8 months).

- 1) **This person's travel expenditures exceeded \$31,000; an average of \$969 per month on travel for one state employee for 32 months.**
- 2) During this short period of time (approximately 693 working days), this person was "traveling/conferencing/etc." for 136 days which amounts to 20% of this person's working days. Of these 136 days, 108 were out of state (16% of working days). Thus, **during an average five day work week, this person is traveling one full work day each week and is out of state traveling six hours of every 40 hour work week.** Is it just coincidence that the state has lost millions of dollars due to failed projects at both LASERS and the Dept. of Revenue in recent years?
- 3) This person spent six days in Santa Fe costing the state \$1,768, three days in Aventura, Florida costing the state \$2,936, five days in San Francisco costing the state \$1,872.

The other person in question served as Assistant Director of LASERS, is now retired, and has recently been elected to the LASERS board. The following occurred during a 26 and a half month period (FY01 through mid October of FY03).

- 1) This person spent \$20,424 on out of state travel, including charges such as \$429 for a rental vehicle in Santa Fe.
- 2) This \$20,424 was expended in 49 "travel" days. **This person was out of state over 8% of working hours and average an expenditure of \$417 per day while traveling.**

LFO comment on LASERS Assistant Director's travel- we question the value of some of these meetings/conferences and are especially concerned with the extensive periods of time that this person was not present at LASERS. We do not believe that this person could possibly perform the critical duties of the assistant director with this travel schedule. We are left with the conclusion that this person was, in fact, not performing the critical duties of asst. director. We offer as proof the following events.

Shortly after this person's travel extravaganza, the director of LASERS requested and received authority from the LASERS board to hire a second assistant director in order to handle the workload that had built up at LASERS. The logical response would have been for the director to demand that the current employee perform the work - instead of hiring yet another assistant director. But the director doesn't have that authority - it rests with the board. If the board had constraints on its budget instead of an infinite pot of resources, they would act more responsibly.

How can an assistant director properly perform the essential business of running an agency when this person is out of state 8% of the time?

LFO Comment:

The director and two assistant directors of LASERS and of Teachers are hired by the system boards. Thus the assistant directors work at the pleasure of the boards, not the director, but the director is responsible for the performance of the system, not the assistant directors. Since the director neither hires or fires the assistant directors, the director has no functional authority over the assistant directors. This clearly undermines the director's authority, interferes with his/her ability to manage the system, and creates a serious chink in the chain of command. This is a possible (and likely) explanation for the LASERS director's request for a second assistant director following the excessive travel by the first assistant director.

Finally, the LFO questions the merits or benefits gained (by the state) by these employee's attendance at many of these conferences or meetings.